

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL**

DISTRICT OF COLUMBIA

**Independent Auditors' Report
on Compliance and on Internal Control
Over Financial Reporting**



**AUSTIN A. ANDERSEN
INTERIM INSPECTOR GENERAL**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



February 4, 2005

The Honorable Anthony A. Williams
Mayor of the District of Columbia
Mayor's Correspondence Unit, Suite 221
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

The Honorable Linda W. Cropp
Chairman
Council of the District of Columbia
John A. Wilson Building, Suite 504
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mayor Williams and Chairman Cropp:

In connection with the audit of the District of Columbia's general purpose financial statements for fiscal year 2004, KPMG LLP submitted the enclosed final Independent Auditors' Report on Compliance and on Internal Control Over Financial Reporting. This report details identified reportable conditions. Reportable conditions involve matters relating to significant deficiencies in the design or operation of internal control over financial reporting that could adversely affect the District's ability to record, process, summarize, and report financial data consistent with the assertions of management in the basic financial statements. The three reportable conditions disclosed in the report are: (1) Management of Disability Compensation Program; (2) Unemployment Compensation Claimant File Management; and (3) District Medicaid Provider Contract Administration (at the D.C. Public Schools' level only). KPMG LLP also disclosed the need for District officials to better comply with procurement laws and regulations.

The report also indicates the extent to which the District corrected the conditions cited in the previous year. In this regard, we are pleased to report the improvements made by the Office of the Chief Financial Officer and District agencies in mitigating the risks associated with the Health Care Safety Net Administration Contract Management and District Medicaid Provider Accounting and Financial Reporting.

KPMG set forth recommendations for correcting the reportable conditions noted. While the Office of the Inspector General will continue to assess the District agencies' implementation of recommendations, it is the responsibility of District government management to ensure that agencies correct the deficiencies noted in audit reports. This Office will work with managers, as appropriate, to help them monitor the implementation of recommendations.

If you have questions or need additional information, please contact William J. DiVello, Assistant Inspector General for Audits, at (202) 727-2540.

Sincerely,



Austin A. Andersen
Inspector General

Enclosure

AAA/ws

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KPMG LLP
2001 M Street, NW
Washington, DC 20036

**Independent Auditors' Report on Compliance and on Internal Control
over Financial Reporting Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Mayor and Council of the Government of the District of Columbia
Inspector General of the Government of the District of Columbia:

We have audited the basic financial statements of the Government of the District of Columbia (District) as of and for the year ended September 30, 2004, and have issued our report thereon dated January 24, 2005, which referred to the adoption of new accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements and not to provide an opinion on internal control over financial reporting. However, we noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control over financial reporting that, in our judgment, could adversely affect the District's ability to record, process, summarize, and report financial data consistent with the assertions of management in the basic financial statements. Reportable conditions are listed below and described in greater detail in Appendix A.

- I. Management of Disability Compensation Program
- II. Unemployment Compensation Claimant File Management

A material weakness is a reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control over financial reporting would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not consider the items listed above to be material weaknesses.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance related to compliance with District procurement regulations that is required to be reported under *Government Auditing Standards* and is described in greater detail in Appendix B.

We also noted certain additional matters that we will report to District management in a separate letter. The status of prior year reportable conditions and instance of material noncompliance are presented in Appendix C.

This report is intended solely for the information and use of the Mayor, Council, the Inspector General of the District, District management, the U.S. Government Accountability Office and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

January 24, 2005

REPORTABLE CONDITIONS IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

I. Management of Disability Compensation Program

The District, through the Office of Risk Management (ORM), administers a disability compensation program under Title XXIII of the District of Columbia Comprehensive Merit Personnel Act of 1978. The most recent actuarial loss reserve analysis was performed in fiscal year 2002. For fiscal years 2003 and 2004, ORM has performed roll-forward procedures, using underlying assumptions included in the last actuarial report, in order to estimate the District's disability compensation liability at each year-end. We recommended that an actuarial analysis be performed for fiscal year 2004, however this recommendation was not implemented. We believe that the use of data that is more than one year old as a basis for these roll-forwards could lead to significant differences between the estimated liability and actual results for individual cases when complete data is available. Further, the accuracy of the underlying data used in the District's analysis has always been difficult to assess due to weaknesses in the maintenance of supporting claims files.

The ORM does not perform a timely review of past claims to determine whether the established reserves remain sufficient. In addition, we determined through claims test work that certain reserves were not removed timely from the tracking system, once a claim is determined to be closed. These conditions increase the risk that the underlying data, which is utilized for the District's roll-forward procedures, may be over- or understated. Additionally, seven out of 81 disability claim case files selected for test work could not be located for our review, and many of those that were provided for our review required extraordinary effort on the part of ORM personnel to locate. This is a similar result as noted in prior years.

We again recommend that ORM contract for an actuarial loss reserve analysis to be performed during fiscal year 2005, and each year thereafter. Additionally, we recommend that ORM:

- Review all active claim files on a periodic basis to determine if the recorded reserve is sufficient or if the reserve needs to be increased or decreased. The review of all active claim files is imperative before each actuarial analysis is performed, since an actuary would be utilizing such information in their analysis.
- Develop an effective managerial system to file and maintain both open and closed case files.

Management Response

ORM has requested monies for an actuarial report in its current budget. It is expected that the actuarial report will take place within the next fiscal year.

All Disability Compensation Program (DCP) files, both active and archived, were housed by the Third Party Administrator (TPA), CLW/CDM, Inc. in fiscal year 2004. CLW/CDM was responsible for maintaining all supporting documentation in each claim file. ORM acquired these files at the conclusion of the contract between the city and CLW/CDM in November 2004. The contract expired pursuant to court order on Friday, October 29, 2004. The archived files were subsequently moved and placed in storage at the District of Columbia General Hospital (DCGH). The active files were moved to 441 4th Street, NW, Suite 800 South. It is assumed that all files were turned over to ORM; however, at this time, it is difficult to verify this assumption. In addition, a number of active claim files were erroneously placed in storage when they should have been forwarded directly to ORM.

REPORTABLE CONDITIONS IN INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Claims Supervisor of CLW/CDM, Inc. was charged with performing timely reviews of the adjusters' decisions establishing reserves. ORM was responsible for conducting periodic reviews of randomly selected claim files to determine if appropriate reserves had been established and/or removed. The previous database system did not allow ORM access to all of the data maintained by CLW/CDM with regard to this aspect of the claims. With the movement of the Third Party Administrator in-house, and obtaining its own Riskmaster database, ORM now has the ability to easily determine whether established reserves are sufficient.

ORM has entered into a contract for services, which entails capturing basic information on all claim files currently in storage into an Excel spreadsheet. This electronic database will allow ORM to effectively manage its closed case files. The new Riskmaster system, which went into operation in November 2004, will allow ORM to effectively manage all open claims files, and those, which are subsequently closed.

ORM expects to hire additional staff to provide more hands on file/reserve reviews and to conduct periodic audits.

II. Unemployment Compensation Claimant File Management

The District's Department of Employment Services (DOES) is responsible for the administration of the Unemployment Compensation Program. In fiscal year 2004, the District made approximately \$114 million in unemployment benefit payments to unemployed former employees of private employers in the District and of the District and federal governments.

While testing internal controls over benefit payments, we observed that DOES was unable to locate 8 out of 30 claimant files supporting these payments. Federal regulations require that DOES maintain documentation supporting all payments of unemployment claims. We noted that DOES has established policies and procedures requiring such documentation be maintained. However, DOES has not created a system of tracking the location of all claimant files and requiring such files to be checked in and out by DOES personnel using the files. We recommend that DOES create a database tracking the location of all claimant files and require that this database be updated each time a file is moved to a new location.

Management Response

Management concurs with the finding. If funding is available, DOES will implement an imaging and retrieval system for Unemployment Insurance documents. A pilot project is to commence within the next three months for imaging and indexing quarterly contribution reports. The imaging will be done by the contractor who currently enters data from these reports.

MATERIAL NONCOMPLIANCE WITH LAWS AND REGULATIONS

Non - Compliance with Procurement Regulations

The District's procurement transactions are primarily governed by statute, as well as rules and regulations outlined in the District of Columbia Municipal Regulations (DCMR). In addition, the Mayor, Chief Financial Officer and Director of the Office of Contracting and Procurement (OCP) can issue directives, orders and memorandums governing procurement actions.

During our audit we reviewed the Office of Contracting and Procurement's list of contracts which required retroactive Council approval. The list was comprised of four (4) D.C. Supply Schedule contracts; five (5) contracts for various critical services; three (3) short-term purchase orders, and thirteen (13) Information Technology contracts. We noted the following:

- All of the contracts were in excess of the one million dollar ceiling but there was no evidence of approval from the Council for each year that required such approval.
- Purchase order amounts were not tracked as a means of ensuring compliance with the procurement dollar limits for some of the contracts.
- Three short-term purchase orders individually less than one million dollars but cumulatively totaling over two million dollars were issued to the same vendor for similar services within the fiscal year. Each purchase order exceeded the agency's small purchase limit.

We also noted that the District does not have a centralized tracking system that identifies all contracts for the fiscal period.

Section 2-301.05a of the D.C. Official Code states that prior to the award of a multiyear contract or contract in excess of \$1,000,000 during a 12-month period the Mayor (or an executive independent agency) shall submit the proposed contract to the Council for review and approval in accordance with established criteria. The requirement for Council approval shall extend to any contract action (which includes modifications and task orders). In cases where the Council has previously approved a contract with base year and option years, where an option year exceeds one million dollars, Council approval will be required again.

Agencies are required to seek retroactive Council approval to authorize any payments over one million dollars under any contract that exceeds one million dollars without prior Council approval.

We recommend that OCP review its current contracting procedures with special focus on the contracting officers or designees and their responsibilities for ensuring compliance with the contract dollar limitations and the approval process. The commodity managers should meet with senior procurement personnel to review the status of certain contracts during the year.

We also recommend that the District design and maintain a centralized tracking system with information that identifies the amount and status of each contract entered into with vendors.

MATERIAL NONCOMPLIANCE WITH LAWS AND REGULATIONS

Management Response

OCP concurs with both recommendations and has already taken two important steps that address each of them. OCP created a new Centralized Contract Tracking System ("CCTS") that went into effect on November 1, 2004. The CCTS allows OCP to track all indefinite delivery/indefinite quantity ("IDIQ") contracts, as well as human care agreements and requirements contracts, to ensure that each contract does not exceed its ceiling. The system: (1) includes all purchase orders issued against a contract; (2) calculates the remaining balance on the contract amount against which orders may be placed; (3) issues a warning when the remaining balance is within 10% of the contract's ceiling amount; and (4) alerts a contracting specialist not to process a requisition against a contract when the dollar amount of the requisition exceeds the contract ceiling.

All contracting officers and contract specialists are required to consult the CCTS for the balance of an IDIQ contract, a requirements contract, or a human care agreement. This system allows OCP to effectively monitor the orders placed against these types of contracts. Monitoring of orders placed against these types of contracts had not previously occurred. Reports are available from the CCTS so that a contracting officer or commodity manager may readily track contract amounts and orders placed against contracts.

Second, OCP provided training in September 2004 to all contracting personnel on the requirements for Council review of million dollar and multiyear contracts. Attendees included contracting officers, contract specialists, and other personnel involved in procurement and the preparation of contract packages for million dollars or multiyear review by Council. This training covered recent issues with million dollar or multiyear contract reviews; statutory requirements for Council review; templates for the million dollar or multiyear contract packages, including an in-depth discussion of the contents of the statutorily-required Council Contract Summary; and case studies for discussion in small groups. Further training on million dollar or multiyear contracts will be conducted as needed.

**STATUS OF PRIOR YEAR MATERIAL NONCOMPLIANCE
AND REPORTABLE CONDITIONS**

Nature of Comment	Type of Comment in FY 2003	Current Year Status
Expenditures in excess of budgetary authorization	Material Noncompliance	Closed
Health Care Safety Net Administration Contract Administration	Material Weakness	Management Letter Comment
District Medicaid Provider Contract Administration	Material Weakness	Reportable Condition at the District Agency (DCPS) level only
Human Resources/Payroll Process Management	Reportable Condition	Management Letter Comment
Unemployment Compensation Claimant File Management	Reportable Condition	Reportable Condition